

Commentary***Restoring The Balance Between Intellectual Property Rights And The Antitrust Laws — The Xerox Case And Its Aftermath***

By
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As the information age progresses and intellectual property increasingly propels our economy, the interplay between antitrust and intellectual property has become a vital concern. Developments in many critical industries, ranging from software to pharmaceuticals to biotechnology, are deeply affected by the relationship between these two areas of the law. One need look no further than the current hearings being jointly conducted by the Federal Trade Commission and Antitrust Division on antitrust and intellectual property to see how important these issues have become.

On one level, there appears to be a tension between the exclusionary rights granted by the intellectual property laws and antitrust's concern with the unlawful exercise of market power. The more enlightened view, however, is that antitrust and intellectual property are complementary regimes, which both encourage the same pro-competitive outcome — innovation. From this perspective, rewarding innovation through patents and copyrights is entirely consistent with antitrust policy as long as the reward is proportionate to the investment in innovation, and is not abused to harm competition.

Cases that delve into the antitrust and intellectual property intersect must therefore perform a delicate balancing act between providing incentives to innovate while putting some limits on how these incentives can be used to harm competition. This juggling act is particularly difficult in high technology markets. Intellectual property can be a critical barrier to entry in these markets. And given the complementary nature of many technology markets — such as operating systems and applications software — firms can easily manipulate their intellectual property to unlawfully acquire market power in related markets.

The Xerox Decision

A recent decision by the Federal Circuit, *C.S.U. v. Xerox*, 203 F.2d 1322 (Fed. Cir. 2000), reveals how this fragile balance between intellectual property and antitrust law can unravel.

In *Xerox* a group of independent service organizations ("ISOs") that serviced high speed copiers and printers claimed that Xerox monopolized the service aftermarket by ending its practice of selling or licensing replacement parts and diagnostic software to ISOs. According to the ISOs, Xerox changed its practices to entrench its market power in the service aftermarkets, and therefore owed them a duty to deal under the antitrust laws.

The Federal Circuit rejected the ISO's antitrust claim with a sweeping pronouncement that betrayed its view that intellectual property rights should virtually always take precedence over antitrust concerns. "In the absence of any illegal tying, fraud in the Patent and Trademark Office or sham litigation, the patent holder may enforce the statutory right to exclude others from making, using or selling the claimed invention free from liability under the antitrust laws." *Xerox*, 203 F.3d at 1327-28. In other words, the antitrust laws could not reach Xerox's refusal to license; the reason for the conduct, its impact on the ISOs or on competition in the service aftermarkets was deemed irrelevant.

This exaltation of intellectual property rights over antitrust considerations sets a very dangerous precedent, which could ultimately shield blatantly anticompetitive conduct from the antitrust laws. Consider the narrow scope of the exceptions to the intellectual property owners right to exclude. The first exception — that the patent was fraudulently obtained from the PTO — is perhaps the most difficult antitrust claim to prove because it requires clear evidence that the patent applicant made knowing and willful misrepresentations, which caused the patent to be issued. See *Nobelpharma AB v. Implant Innovations, Inc.*, 141 F.3d 1059 (Fed. Cir. 1998). Similarly, the second exception — the so-called sham litigation exception — is limited to cases that are "objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits." See *Professional Real Estate Investors, Inc. v. Columbia Pictures Industries*, 508 U.S. 49 (1993).

What's more, the third, final and only truly substantive exception — using the patent to force purchasers to take an unpatented separate product — is by no means the only circumstance where a refusal to license an intellectual property right could be used to harm competition. Former Federal Trade Commission Chairman, Robert Pitofsky, recently made this very point in criticizing the *Xerox* decision. See Remarks by Robert Pitofsky, Chairman of the Federal Trade Commission to the American Antitrust Institute, June 15, 2000. Pitofsky cited, for example, the plausible scenario of a patent holder with substantial market power refusing to sell or license unless purchasers boycott the patent holder's potential competitors. While such conduct might violate the antitrust laws in a non intellectual property context, see *Lorain Journal Co. v. United States*, 342 U.S. 143, 155 (1951), Pitofsky questioned whether it would be immunized from antitrust scrutiny under *Xerox* if intellectual property rights were at issue.

Any doubts about *Xerox* shielding anticompetitive misuses of intellectual property rights should have been dispelled by the district court's decision in *Townshend v. Rockwell Int'l Corp.*, 2000-1 Trade Cas. ¶ 72,890 (N.D. Cal. 2000). *Townshend* involved antitrust counterclaims to a patent infringement suit brought by the owners of 56k modem technology. The antitrust plaintiffs alleged that the underlying patents were invalid, that the technology under the patents resulted from fraud on a trade association, and that the patents were made available to competitors only if they cross-licensed their technology to the patent holder. Rather than addressing the serious antitrust issues raised by these allegations, the district court dismissed them "because a patent owner has the legal right to refuse to license his or her patent on any terms, the existence of a predicate condition

to a license agreement cannot violate the antitrust laws." *Xerox* was among the authorities cited in support of this problematic decision.

Split Between The Circuits

The *Xerox* decision also departs from prior Circuit Court decisions on this issue. For example, in *Data General Corp. v. Grumman Sys. Support Corp.*, 36 F.3d 1147 (1st Cir. 1994), the plaintiff alleged that the defendant violated the antitrust laws by refusing to license diagnostic software that would have given the plaintiff the ability to compete in the service market. The Court rejected the antitrust claim. However, it held that a valid copyright established only a rebuttable presumption that the refusal to deal was lawful. While the Court declared that this presumption could be rebutted only in the rare instances where imposing antitrust liability would not frustrate the Copyright Act's objectives, unlike *Xerox*, *Data General's* rebuttable presumption standard permits an examination of whether the refusal to license was solely designed to harm competition.

The Ninth Circuit adopted a modified version of this approach in *Image Technical Servs. v. Eastman Kodak Co.*, 125 F.3d 1195 (9th Cir. 1997), where it affirmed a jury verdict finding that Kodak unlawfully monopolized the aftermarket for servicing Kodak copiers by refusing to sell replacement parts to ISOs. In a slight deviation from *Data General*, the Ninth Circuit found that "exclusionary conduct can include a monopolist's unilateral refusal to license" an intellectual property right, even though invoking such rights "is a presumptively valid business justification" for refusing to deal. *Kodak*, 125 F.3d at 1218. It then found the presumption rebutted by the pretextual nature of Kodak's intellectual property defense.

Notwithstanding the conflict between *Xerox* and these cases, the Antitrust Division recommended against the Supreme Court reviewing the *Xerox* decision. The government justified its position by fudging the disagreement between the Circuits and by questioning whether the Federal Circuit intended to suggest that unilateral refusals to license or sell intellectual property rights are virtually exempt from antitrust scrutiny. Perhaps influenced by the Antitrust's Division's position, the Supreme Court declined to resolve this conflict.

Does Xerox Create A Conflict That Need Not Exist?

Given the Supreme Court's current unwillingness to clarify this issue, the question remains; how should the courts deal with this question when it inevitably resurfaces? The answer, surprisingly enough, can be found in the general harmony between core antitrust principles and intellectual property rights. At the outset, it is important to note that recent antitrust decisions, and the antitrust agencies, no longer presume that intellectual property rights necessarily confer market power upon their owners. See 1995 U.S. Department of Justice and Federal Trade Commission Antitrust Guidelines for the Licensing of Intellectual Property at § 2.2. As a result, if there are actual or close substitutes for a particular product, process or work, its owner will not have market power, and therefore, no obligation to cooperate with rivals under the antitrust laws.

Moreover, when an intellectual property right does confer market power, that power would not by itself violate the antitrust laws. This is consistent with the general antitrust principle that firms that have lawfully achieved monopoly power due to their su-

perior acumen, skill or foresight can reap the benefits of their success. Thus, a lawful monopolist is perfectly free under the antitrust laws to charge monopoly prices. And the antitrust laws generally permit firms to freely choose with whom they will do business. *United States v. Colgate*, 250 U.S. 300, 307 (1919).

A lawful monopolist violates the Sherman Act for refusing to deal, however, if its conduct harmed competitors and was designed and had the effect of excluding competition and thereby entrenching or extending the monopolist's market power. One example of such a violation involves a monopolist boycotting customers or suppliers who deal with its potential competitors. But the antitrust laws require lawful monopolists to cooperate with rivals only in two narrow situations: (i) where the monopolist changes an existing and longstanding practice of dealing with competitors with the effect and intent of destroying competition or obtaining a monopoly (see *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985); and (ii) where the monopolist denies rivals access to an essential facility, which cannot be duplicated and which is necessary for firms to compete in the market. *Otter Tail Power Co., v. United States*, 410 U.S. 366 (1973).

Given how rarely the antitrust laws proscribe a lawful monopolist's refusal to deal, there is simply no reason to exempt refusals to deal involving intellectual property rights from the antitrust laws. The only difference in the intellectual property context should be that the owner of an intellectual property right with substantial market power can legitimately refuse to create competition against itself within the scope of the intellectual property right. That rule appropriately protects the economic incentives to innovate that underpin the intellectual property laws. However, when intellectual property rights are invoked as a pretext to extend a firm's market power into adjacent markets beyond the scope of the intellectual property right, the antitrust laws should apply.

Conclusion

The *Xerox* decision threatens to undermine the tenuous doctrinal balance between the antitrust laws and intellectual property rights. While the Federal Circuit's concern with preserving incentives to innovate is certainly well founded, its approach may in fact have the opposite result. If the *Townshend* decision is any guide, *Xerox's* sweeping language will be used to shield the anticompetitive exploitation of intellectual property rights from antitrust scrutiny. While a patent holder is under no general obligation to create competition against itself within the scope of the patent, it cannot condition terms of availability that will further entrench or extend its market power into other markets. If *Xerox* prevents courts from condemning such conduct under the antitrust laws, competition and ultimately innovation will be diminished. Hopefully, the next time this issue arises, the Supreme Court will choose to resolve it. ■